# Impact of OECD and EU Tax policy over treasury activities

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# Agenda

- Luxembourg as a treasury centre
- OECD and EU tax policy
- Possible impacts on treasury activities
- Conclusion
- Q&A

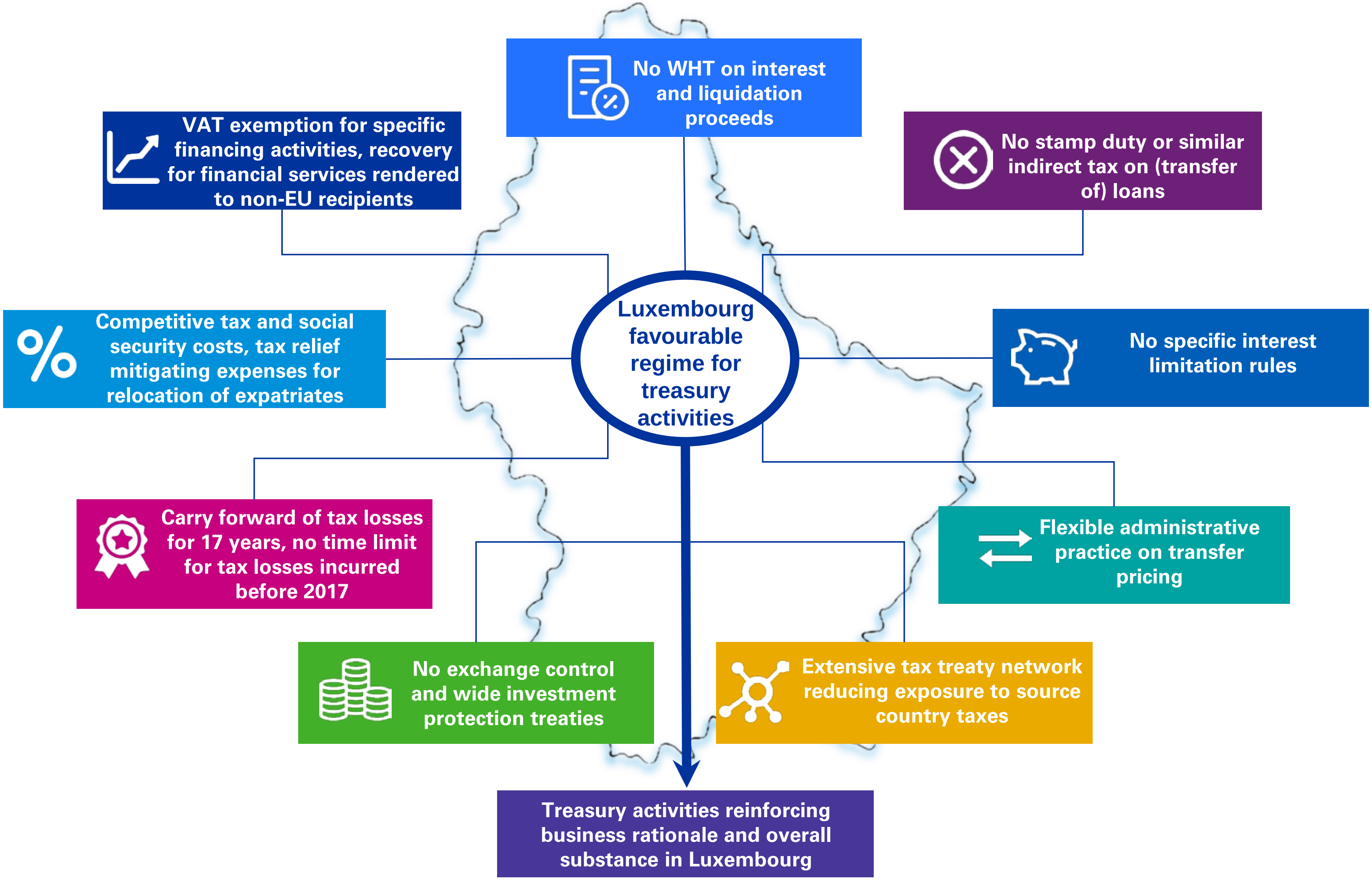
# Luxembourg as a treasury centre

# Key tax factors for treasury centres

**When establishing treasury centres, the following key tax factors should be assessed:**

| | |
|---|---|
| **Taxation of Treasury Centre's profits** | Consider **local income taxes** on the **Treasury Centre's profits** as well as the taxation of such profits at the **parent company level.** |
| **Withholding taxes** | Many countries charge a gross-income tax on **certain payments made to foreign payees**, including interest and dividend payments, which may be reduced via double tax treaties. |
| **Deductibility of interest and similar payments** | Special rules (e.g., Thin-cap regimes) may apply to **limit or deny the tax deductibility of interest and similar payments** made by the affiliates (e.g., on internal funding). |
| **Treaty network** | Treaty networks can reduce the taxes paid with regard to **payments between treaty eligible entities.** |
| **Tax nexus and/or permanent establishment** | Global finance personal should be properly leveraged throughout the organization to prevent unintended **taxable presence in various countries.** |
| **Non-income taxes** | **Value-added, excise, capital, stamp and other taxes** need to be properly monitored. |
| **Transfer pricing** | Depending on the **functions and risks** of the treasury center and the services it provides, various types of compensation will be required. |
| **Foreign currency exchange gain or loss** | Centralizing treasury operations may result in increased FX volatility for book and tax; consider managing FX risk with **hedging strategy**. |

# Luxembourg as a Treasury Centre - Current regime



# Luxembourg current tax environment

| | Corporate income and municipal business tax | Net wealth tax | Withholding tax | VAT/indirect tax | Personal income tax |
|---|---|---|---|---|---|
| **Tax rate** | **27.08%** in 2017, falling to **26.01%** as from 2018 (for entities established in Luxembourg City) | **0.5%** (0.05% on the part exceeding € 500 mio) of unitary value (non-exempt assets financed by equity); **minimum NWT** applies (see below) | 0% on interest and liquidation proceeds; 15% on dividends if no exemption/reduction applies | Standard VAT rate of **17%** (lowest rate in European Union); reduced rates of **14%, 8% and 3%** | Progressive tax rates from **0%** (on income < EUR 11.265) to **42%** (on income > EUR 200,004) + 7-9% unemployment fund contribution |
| **Exemptions** | Exemptions/reductions available under **participation exemption** or extensive **double tax treaty** network | Exemptions/reductions available under **participation exemption** or extensive **double tax treaty network** | Exemptions available for dividends based on participation exemption and double tax treaties | VAT exemption for e.g. **credit** granting, negotiation/management of **credit/credit guarantees**, with input VAT recovery for financial services rendered outside the EU | Exemptions available for benefits granted to expatriates (recruited or assigned to Luxembourg) e.g. housing, school fees, cost of living allowance |
| **Other considerations** | **Carry forward of tax losses** for 17 years, with no limit for losses incurred prior to 2017<br><br>**No** thin capitalization or earning stripping rules for financing activities<br><br>**Functional currency** regime for tax purposes<br><br>**Fiscal unity** regime<br><br>Investment **tax credit** | Possible reduction through the allocation of a **5 year net wealth tax reserve**<br><br>**Minimum** NWT: € 4,815 for holding/financing companies | **Planning available** for specific types of financing tools | No stamp duty on the granting and transfer of loans | Capped social security costs with contributions due up to an annual gross remuneration of EUR 119,915.16 for 2017 (at index 794.54)<br><br>No tax on capital gain realized on securities held for more than 6 months (if the shareholding has never exceeded 10% over the five years preceding the sale) |

# Amended Transfer Pricing Rules for Intermediary Financing Activities in Luxembourg

On December 27, 2016, a circular addressing intermediary, intra-group financing activities was published, *Circulaire L.I.R n°56 1 - 56bis 1 du 27 décembre 2016* ("the Circular").

Based on this new Circular, any Luxembourg company performing intermediary, intra-group financing activities need to respect certain requirements as of FY2017:

## 1. Equity at risk:

The Circular states that the risks borne by an entity on its intercompany loans have to be covered by equity.

- ✓ The **safe harbor rule** allowing to limit the equity at risk to 1% of the financing volume (with a cap at EUR 2 million) **does no longer exist**.
- ✓ The **probability of default and expected recovery in case of default** of each group borrower of the financing Luxembourg entities of the group need to be assessed to estimate the appropriate equity at risk

## 2. Margin:

A Luxembourg company in an intermediary, intra-group financing position has to demonstrate the **arm's length** character of its remuneration for the financing activity (i.e. the taxable margin).

The **level of the margin** is dependent on the equity at risk, the loan type, and the underlying investment.

# Amended Transfer Pricing Rules for Intermediary Financing Activities in Luxembourg

## 3. Organizational Substance:

The Circular states that the Luxembourg entity needs to have **adequate organizational substance** to perform its intermediary financing activity and control the financing transactions.

- ✓ A **qualified board** having appropriate professional knowledge
- ✓ A **majority of board members** should be Luxembourg resident or, if non-Luxembourg resident, should be taxable for at least 50% of their income (listed in the Circular) in Luxembourg. However, a board with a majority of foreign board members should be acceptable if it can be evidenced that the foreign board members regularly come to Luxembourg to make the important decisions of the company.
- ✓ **Decision-making process** throughout the year happening **in Luxembourg**
- ✓ **Qualified "personnel"** to control the financing transactions and monitor the related risks.

## 4. Arm's length interest rates:

The Luxembourg financing company must demonstrate that the **interest rate on its loan receivables is at arm's length.**

# Cash pooling - Transfer Pricing considerations

In the context of a cash pool activity, two aspects have to be considered:

❑ The interest rates applied on the short term loans are arm's length

❑ The remuneration for the functions performed, the risks assumed and the assets used respects the arm's length principle

**Interest rates / Guarantees**

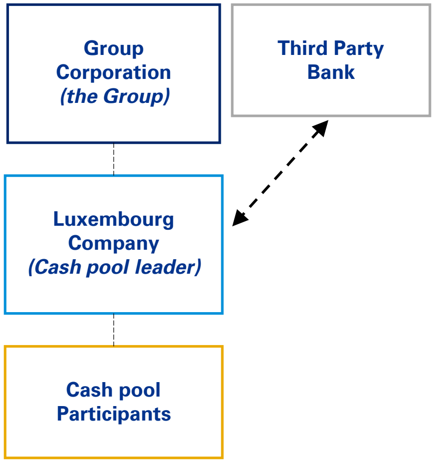
Take into consideration :

- The credit rating of all the cash pool participants or the credit rating of the main entities, or pool of credit ratings?
- The currency of the loans
- The contractual terms of the loans
- The guarantees in place
  - ✓ Do the cash pool participants pay a guarantee fee to the guarantor ?
  - ✓ Do they benefit from an implicit guarantee ?
- The participants' remuneration needs to be aligned to their respective contributions (c.f. ConocoPhilips case law).

**Remuneration of the cash pool leader**

- The cash pool leader's remuneration for the functions performed, the risks assumed, and the assets used.
- The remuneration of the cash pool leader mainly depends on the cash pool structure: pass-through / service provider or risk-taker.
- Remuneration of the different functional risk profile: service fee versus spread.
- Substance
  - ✓ Control of risks;
  - ✓ Capacity to assume, monitor and manage risks.

**Cash pool structure**



# OECD and EU tax policy

# OECD - BEPS - Background

| | |
|---|---|
| Minimum Standards | Harmful Tax Practices (5)<br>**Preventing Tax Treaty Abuse (6)**<br>Country-by-Country reporting and Transfer Pricing Documentation (13)<br>Dispute Resolution (14) |
| Revision of existing standards | Avoidance of Permanent Establishment Status (7)<br>Aligning Transfer Pricing Outcomes with Value Creation (8-10) |
| Common approach / Best practices | Hybrid Mismatch Arrangements (2)<br>Interest Deductions (4)<br>CFC Rules (3)<br>Disclosure Rules (12) |

**Multilateral instrument (15)**

# BEPS implementation phase in Luxembourg

**BEPS 5**: changes to article **50*bis* LITL on IP** / **Exchange of tax rulings**

**BEPS 6**: Impact on **tax treaty policy** / Signature of the **Multilateral instrument** - BEPS 15

**BEPS 13**: Signature of the MCAA (OECD) / EU **CbCR Directive** implemented

**BEPS 14** : Signature of the **Multilateral Instrument** / EU Directive on **dispute resolution** mechanism

Implementation of **minimum standards**

# EU reaction to BEPS

*Draft Directives on : C(C)CTB, Public Country-by-Country Reporting, Disclosure requirements for intermediaries*

Directive on dispute resolution (ECOFIN agreement – May 2017)

**Anti-tax avoidance Directive 2 (May 2017)**

**Anti-tax avoidance Directive 1 (July 2016)**

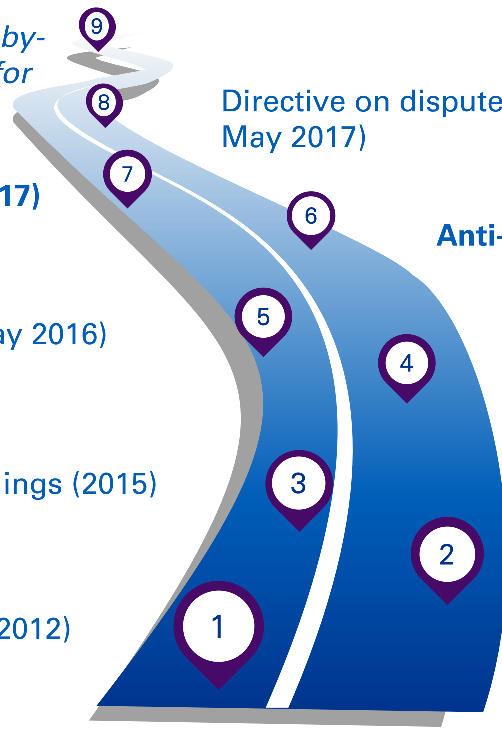
Country-by-Country Reporting Directive (May 2016)

State aid investigations (on-going)

Directive on automatic exchange of tax rulings (2015)

Changes to the PSD (2014/2015)

EU Action plan against tax evasion (2012)



# EU Anti-Tax Avoidance Directive (ATAD 1)

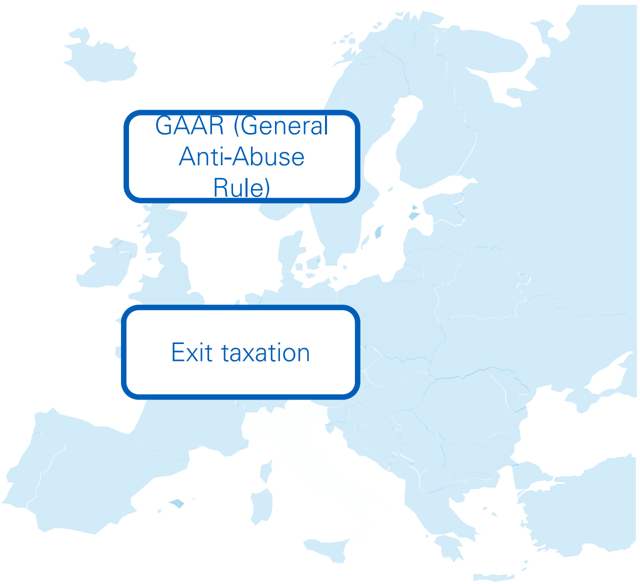
## *BEPS and non-BEPS related measures*

Interest deduction

CFC

Hybrid mismatch

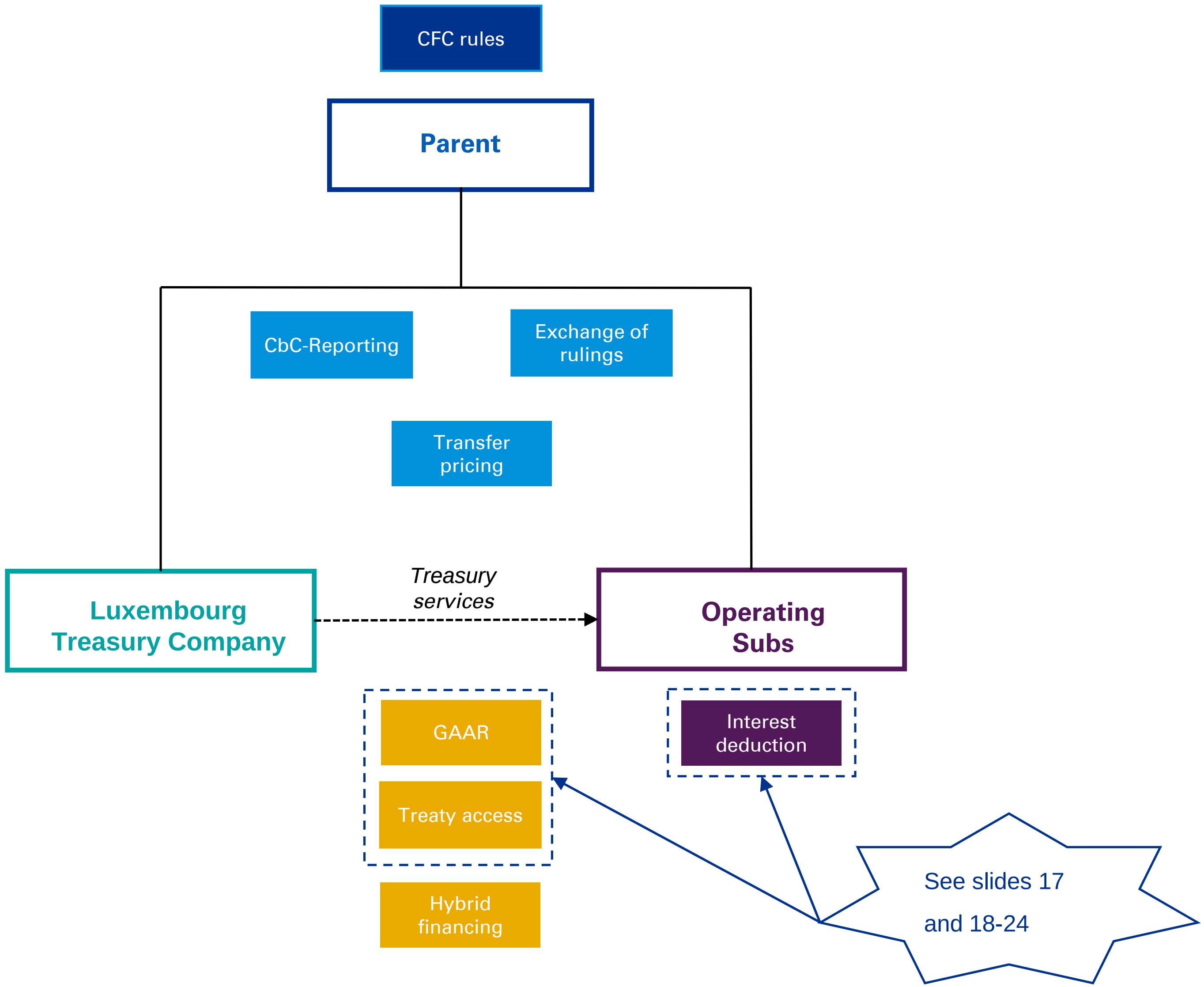
Modified by ATAD 2 - as from 2020



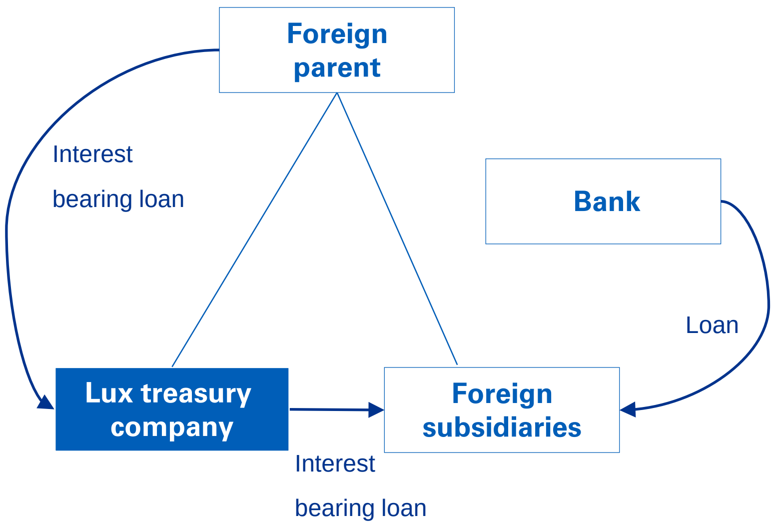

...for a minimum level of protection

# Possible impacts on treasury activities

# Possible impact of BEPS and ATAD 1/ATAD 2



# ATAD 1- Interest limitation




## Thresholds

- Exceeding borrowing costs
- Principle : 30% of taxpayer's EBITDA or (option) up to EUR 3,000,000
- Group ratio rules

## Scope

- Third party or intra-group loans
- EU or non-EU lenders
- Applicable as from January 1, 2019

## Impact analysis

- No impact for Lux treasury company as long as no excess borrowing costs arising from financing activity
- Impact on Foreign subsidiaries to be monitored

# Treaty access under Multilateral Instrument (MLI)

## The MLI in a few figures

**71 signatories**

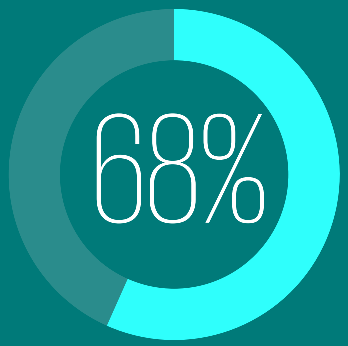
On 17 August 2017

**1100** Number of Treaties covered

**Minimun standards+**

Luxembourg went for limited impact only

Expected entry into effect **2019/2020**




of CTAs for Luxembourg (= 55 over 81 treaties)

# Luxembourg tax treaties and MLI
# 55 Covered Tax Agreements* (CTA)

| Americas | Europe/Eurasia | | | ASPAC | Africa / Middle-East |
|---|---|---|---|---|---|
| Barbados*** | Andorra | Ireland | Romania | China | Bahrain*** |
| Brazil*** | Armenia | Isle of Man | Russia | Hong Kong | Brunei*** |
| Mexico | Austria | Italy | San Marino | India | Israel |
| Uruguay | Azerbaïjan*** | Jersey | Serbia | Indonesia | Morocco*** |
| Canada | Belgium | Kazakhstan*** | Slovak R. | Japan | Qatar*** |
| Trinidad and Tobago*** | Bulgaria | Latvia | Slovenia | Korea | Saudi Arabia*** |
| US*** | Croatia | Liechtenstein | Spain | Laos*** | Seychelles |
| --- | Czech Rep. | Lithuania | Sweden | Malaysia*** | *Senegal* |
| Panama** | Denmark | Macedonia*** | Switzerland | Mauritius | South Africa |
| | Finland | Malta | Tajikistan*** | Singapore | United Arab Emirates*** |
| | France | Moldova*** | Turkey | Sri Lanka*** | — |
| | Georgia | Monaco | Ukraine*** | Taiwan*** | Tunisia** |
| | Germany | *(Mongolia)**** | UK | Thailand*** | |
| | Greece | Netherlands | Uzbekistan*** | Vietnam*** | |
| | Guernsey | Norway | --- | | |
| | Hungary | Poland | Estonia** | | |
| | Iceland | Portugal | | | |

* As at 17 August 2017: 55 CTAs / 81 tax treaties
Covered tax agreements (including Senegal, which is not yet in force)

** Jurisdictions having expressed their intent to sign the MLI

*** Treaty jurisdictions having not signed the MLI

# MLI Luxembourg choices: not far beyond the minimum standards

- Transparent entities (BEPS 2)
- Switch to tax credit (Option A) (BEPS 2)
- Specific activity exemptions (Option B - PE) (BEPS 7)
- Preamble & PPT (BEPS 6)
- Mandatory arbitration (BEPS 14)

# Treaty Abuse (Art. 6-7 MLI)

## Minimum Standard

- **Preamble** language regarding purpose of treaties (art. 6 MLI)
- **Principal Purpose Test – PPT** (art. 7 MLI)

## Possible LOB (Simplified or Detailed)?

- In principle **no S-LOB possible** (based on current choices)
- **Detailed LOB** still possible based on bilateral negotiations (Canada, Chile*, Colombia*, Kuwait*, Poland, Senegal, Seychelles)

* No double tax treaty with Luxembourg

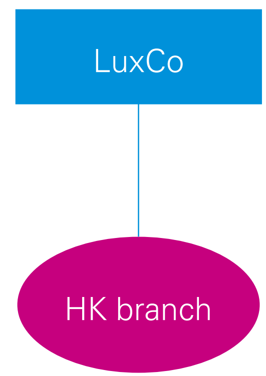
# Treaty Abuse - Preamble (art. 6 MLI)

## Purpose of tax treaties:

- *Elimination of double taxation*
- *No opportunities for non-taxation or reduced taxation through tax evasion or avoidance*

Preamble relevant to the interpretation of a tax treaty's provisions

## Example




Exemption of income derived from loans allocated to branch (treaty application)

Non taxation of interest income - application of territorial regime

**Will the preamble challenge the application and interpretation of articles 5.2, 7.1, 22.2.a of the tax treaty + newly inserted Principal Purpose Test (PPT) clause?**

<u>Expected impact</u>: to be determined on a case-by-case basis

# PPT under MLI vs GAAR under ATAD 1

**MLI – PPT** (Article 7.1)

Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having **regard to all relevant facts and circumstances**, that obtaining that benefit was **one of the principal purposes** of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the **object and purpose** of the relevant provisions of the Covered Tax Agreement."

**ATAD 1 - GAAR** (Article 6)

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the **main purpose or one of the main purposes** of obtaining a tax advantage that defeats the **object or purpose** of the applicable tax law, are **not genuine** having **regard to all relevant facts and circumstances**. An arrangement may comprise more than one step or part.

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for **valid commercial reasons which reflect economic reality**.

Compliance with EU Law!

3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.

**---------> importance of substance and valid economic reasons**

# PPT/GAAR - impact on interest paid to treasury centres

| Interest paid by EU countries | Interest paid by non-EU countries |
|---|---|
| Both GAAR (ATAD 1) and PPT (MLI) are applicable* and provide for similar requirements (the scope of the GAAR is however larger as not limited to treaty context) | Only MLI (i.e. not ATAD 1) is applicable* |

PPT/GAAR impact may however be limited compared to current situation, as many countries already apply anti-abuse rules in their domestic law and/or have concluded double tax treaties including anti-abuse rules or limitation of benefits (LOB)**

Examples of Luxembourg CTAs without LOB providing for a WHT rate on interest that may be more favorable than domestic rate***, where GAAR/PPT impact may therefore need to be reviewed: Iceland, Mauritius, Singapore, South Africa, UK etc.

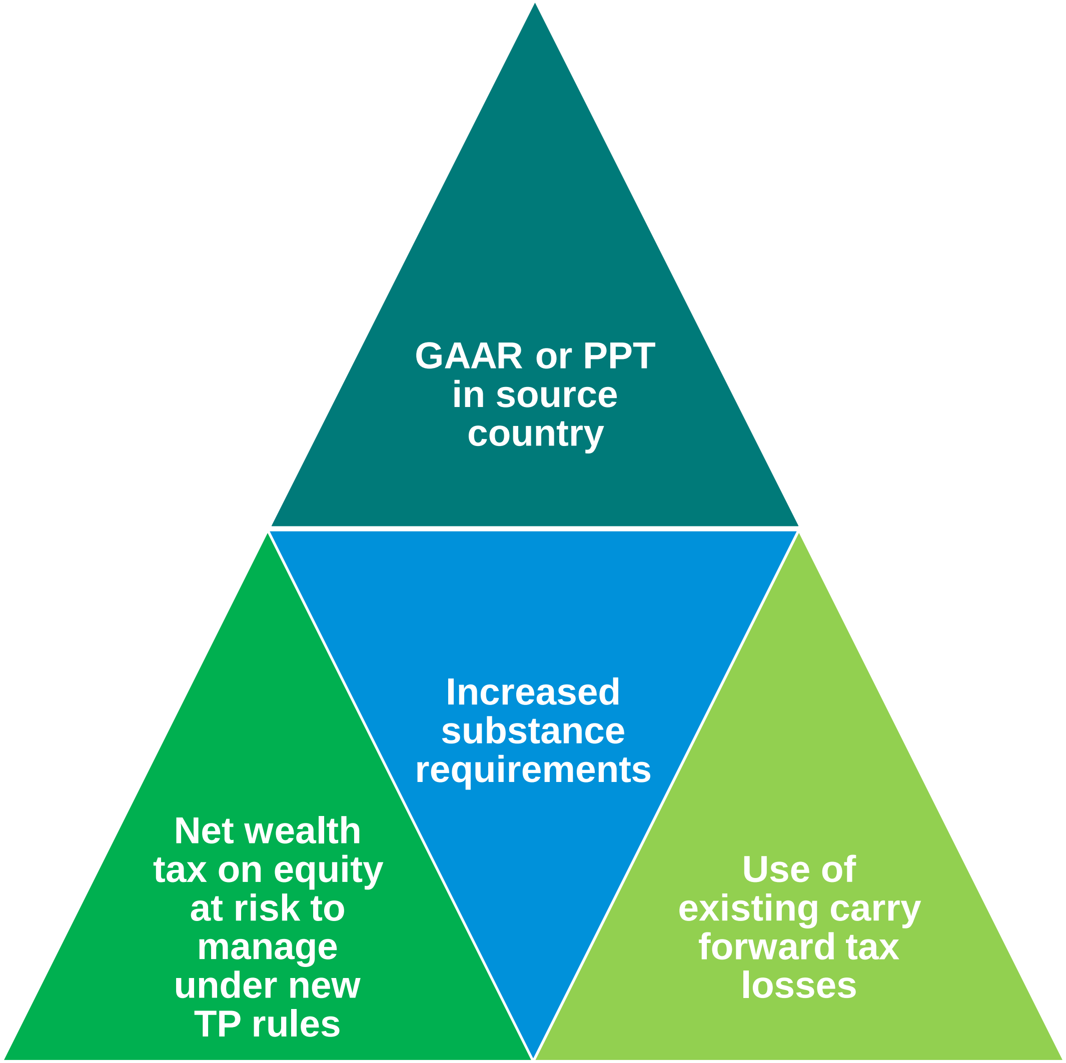
* MLI applicable to the extent the related tax treaties are CTAs as per the MLI - Luxembourg has double tax treaties with all EU Member States, which (except tax treaty signed with Cyprus, which is not yet in force) are all CTAs (Estonia has only expressed its intent to sign MLI)

** CTAs concluded by Luxembourg and including anti-abuse rules/LOB: Czech Republic, Georgia (only dividends, interest and royalties), India, Mexico (only for interest and royalties), Russia, Senegal, and (only for dividends) United Kingdom

*** The CTA concluded with e.g. Russia provides for a more favorable WHT rate on interest than domestic law but already contains a LOB provision (article 29)

# Conclusion

# The future landscape for Luxembourg as a treasury centre



# Q&A

# Thank you

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